MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 3, 2022/2023

BFE2074 – FINANCIAL ECONOMICS

(All sections / Groups)

2 OCTOBER 2023
9.00 a.m - 11.00 a.m
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consists of **TWO (2)** printed pages with **FOUR (4)** structured questions.

2. Answer **ALL** questions. All questions carry equal marks and the distribution of the marks for each question is given.

3. Please write all your answers in the Answer Booklet provided.

ANSWER ALL QUESTIONS (100 MARKS)

Question 1

(a) Suppose that real consumption expenditures in a nation are RM10,000, real investment expenditures are RM12,000, real government expenditures are RM5,000, real expenditures on imports are RM2,000, real expenditures on exports are RM1,000, and transfer payments are RM400. Calculate the nation's levels of (i) real income, (ii) the amount of absorption, and (iii) its trade balance.

(6 marks)

(b) The central bank on 21st August expects Malaysia to record a slower growth in year 2023, closer to the lower end of its growth forecast range of 4 to 5 percent. Despite the forecast, determine the reasons that may lead the value of Ringgit Malaysia (RM) to appreciate by using the absorption approach.

(9 marks)

(c) The portfolio approach proposed that households desire to distribute their wealth over three types of instruments. Identify the three types of instruments and using the three types of instruments, evaluate the effect of an increase in the domestic interest rate on the exchange rate value between the domestic and foreign currencies.

(10 marks)

(Total: 25 marks)

Question 2

(a) Differentiate between Expectations theory and Preferred Habitat theory.

(6 marks)

(b) Suppose that the annual nominal interest rate on a domestic bond is 4 percent and the expected rate of inflation is 2 percent per year whereas the foreign annual nominal interest rate on a similar bond is 6 percent and the expected rate of inflation is 3 percent per year.

i. Using the concept of uncovered interest parity to the nominal interest rates, examine the exchange value of the domestic currency during the year.

(4 marks)

ii. Is the real interest parity hold? Examine using the Fisher equation.

(5 marks)

(Total: 15 marks)

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Question 3

(a) Contrast between transactions motive, precautionary motive and portfolio motive for holding money.

(6 marks)

(b) Illustrate with the help of a diagram against real income, the export schedule and identify **TWO (2)** key factors in determining foreign expenditures on a nation's exports.

(5 marks)

(c) Identify factors that shift the LM schedule downward and to the right.

(2 marks)

(d) Assuming high capital mobility and a floating exchange rate system, with the help of IS-LM-BP diagram, analyse the effect on (i) nominal interest rate, (ii) domestic real income, (iii) trade balance and (iv) the value of domestic exchange rate when the nation's central bank conducts fiscal consolidation.

(17 marks)

(e) Based on the situation in part (d), if the central bank conducts a system of fixed exchange rates (without sterilization), determine the effect on (i) nominal interest rate and (ii) domestic real income.

(5 marks)
(Total: 35 marks)

Question 4

(a) Determine how the IS-LM model related to the aggregate demand schedule.

(6 marks)

(b) Differentiate between exchange rate depreciation and exchange rate devaluation.

(4 marks)

(c) An exchange rate devaluation in a system of fixed exchange rates would cause aggregate demand to increase with higher degrees of capital mobility. Analyse using the IS-LM-BP model.

(15 marks)
(Total: 25 marks)

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